

Virtuous bankers? Banking, reputation and regulation in nineteenth century England and Wales

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**Virtuous Bankers? Banking, reputation and regulation in nineteenth century
England and Wales**

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Abstract

In this chapter, we investigate the motivations of bank directors and the mechanisms to ensure their virtuous behaviour. In particular, by drawing on two contrasting case studies, this chapter establishes what role the community played in determining behaviours of bank directors. Overall, we find that it was in the interests of joint-stock banks to govern themselves responsibly and honestly/virtuously in order to gain a trust and serve the wider community in which they operated in.

Key words: joint-stock banks; directors; virtue; behaviour; common good

Introduction

Following the financial crisis of 1825/6, legislation led to the establishment of joint-stock banks in competition to the existing private banking institutions. The 1826 Bank Act aimed, in principal, to stabilise the banking system in England and Wales. The joint-stock banks formed under this legislation differed greatly in comparison to existing private banks as they possessed a formal hierarchical structure with an elected board of directors, salaried managers, and were owned by shareholders. Private banks, in contrast, were privately owned and were limited to a maximum of six partners. Joint-stock banks established themselves successfully from 1826 onwards, to the extent that they eclipsed the private banks by the end of the nineteenth century and became the dominant form of retail bank in the UK by 1900. This chapter will consider the behaviour and decision-making of boards, directors, and managers of the new joint-stock banks, and attempt to examine the extent to which their motivations and actions were virtuous and for the greater good of the communities in which they operated.

Initially these bankers did not have a professional body to ‘vet’ them; to define a set code of conduct; or to define professional standards and norms to follow. Indeed, this did not occur until 1878 with the creation of the Institute of Bankers. This paper therefore investigates the ways in which bankers forged and agreed upon a common set of behaviours to follow in the absence of a governing body for their profession. The early nineteenth century was also an era when the Bank of England did not formally act as a central bank. In the absence of a professional body or a central regulatory authority, did a common set of ‘virtuous’ behaviours in these new financial institutions exist? How were decisions informed by local networks, communities and

cultures? Were decisions made from a ‘virtuous’ business perspective (the institutional perspective) and for the broader common ‘good’ of the local community?

Overall, we find that it was in the interests of joint-stock banks to govern themselves responsibly, honestly, and virtuously in order to establish a trustworthy reputation, with the purpose of serving the community in which they operated in, although moral obligation did not always lead to moral practice. On the whole, directors, were ‘insiders’ and established members of their communities, and by behaving in a non-virtuous fashion, they would lose their position - whether that be social, political and/or economic - in their communities. With such a high penalty, this style of peer monitoring was, by and large, effective. In answering such questions, we shed light on the early governance of joint-stock banks and the behaviours of the bankers that ran them. This research discerns how such directors and managers identified their roles without stringent legal advice or remit, and with few templates to follow, other than that from the private bankers, whom they wished to distance themselves from.

The chapter follows a case study approach through the examples of Manchester and Liverpool District Bank and the National Provincial Bank of England in order to make some broader generalisations about the system of joint-stock banking. The comparative element is important as the two examples highlight the different ways in which a joint-stock bank could function and how codes of conduct were created. The Manchester and Liverpool District Bank located itself in the commercial hub of the North West of England, while the National Provincial Bank of England, by contrast, possessed a large multi-regional banking network that stretched across most of England and Wales. Both used local networks, actors and communities

but in different ways. This paper also utilises material from bank archives, such as deeds of settlement and Board of Directors minute books in particular, and also contemporary banking publications.

Motivations

Virtue ethics acknowledges that the principles of virtue are created by, and embedded in, a particular culture or community and examines the actions of individuals in pursuing a ‘common good’ (Hendry 2013, p.70-74). Virtue ethics looks to the character, integrity and motivations of the decision-maker (Nielson, 2006). Such traits and character are developed through learning, particularly learning from the culture and community in which the individual is located (MacIntyre, 1984). O’Brien considers the ‘common good’ as taking place within ‘a complex web of mutual relationships that enable individuals to achieve far more than they would if left to their own devices in isolation’ (O’Brien, 2009: 29). The ethics or virtue of an individual is thus placed within a social context.

In a business sense, virtue ethics, therefore, examines more than the success of an individual or a company through profits or longevity, but, rather through the means by which such success has been achieved, as well as the motivations behind the business and those that ran it. This section examines the motivations behind those directors that established joint-stock banks in the first half of the nineteenth century.

During the severe liquidity crisis that arose at the end of 1825 and continued into 1826, the public lost confidence in the private country banks’ ability to meet their obligations and ‘people started to hoard their cash rather than entrust it to a banker’

(Collins, 1998, p.17). A total of 93 banks in England and Wales failed as a result of the crisis (approximately 15 per cent of the total) and there was widespread loss of confidence in the banking system (King, 1936: 35-47; Pressnell, 1956: 477-500). Fewer banks meant a reduction in the means of payment and an immobilisation of capital (Pressnell, 1956: 491). In response to these failures in the banking system, those associated with joint-stock banking in Scotland and Ireland (countries in which joint-stock banking had developed from 1810 and 1821 respectively) sought to export their model of banking; one they advocated as a safer alternative than private banking.

Thomas Joplin, a merchant associated with joint-stock banking in Ireland, and who had a long standing ambition to promote such a bank in England, saw the 1825/6 crisis as an opportunity to re-assert his claims about the virtues of joint-stock banking. This effort eventually culminated in the successful promotion of National Provincial Bank of England in 1833. In one of his early prospectuses, he claimed that:

‘it is highly desirable that private banks should convert themselves into joint stock companies, and that to facilitate this successfully in good faith to all concerned, would be a great public advantage’ (Gilbart, 1836 p.147).

The ‘great public advantage’, or common good, of the joint-stock style of banking was established by one of the first districts in England and Wales to take up the joint stock model - Yorkshire. The crisis of 1825 had ‘wrought havoc among the unstable Yorkshire banks and was felt with particular severity in the region’ (Crick and Wadsworth 1936, p.201). Sayers describes the ‘slaughter of the 1825 crisis among the Yorkshire private banks’ (Sayers 1957, p.17). Joplin assisted with a promotion in this county: the Huddersfield Banking Company (Crick and Wadsworth, 1936: 203). In the town of Huddersfield, five out of six private banks failed in the 1825/6 crisis.

The Huddersfield Banking Company prospectus was clear in its view of the benefits of new joint-stock banking establishments, stating that:

‘this district has not only suffered the evils resulting from the general suspension of demand, which has been common to all manufacturing districts, but has been visited with an additional local evil in the failure of five banking establishments; this instantaneously withdrawing from circulation some hundred thousand pounds, and causing losses to a very considerable amount’.¹

In the decade following the 1826 Bank Act, twenty new joint-stock banks were registered in Yorkshire alone. The foundation of many of the new joint-stock banks in Yorkshire took place in a ‘blaze of local patriotism’ (Crick and Wadsworth 1936, p.206). Given the failure rate in the 1825/6 crisis, such fervour is understandable.

Those in favour of joint-stock banking argued that one of its key public benefits was stability and the ability to extend greater volumes of credit. The Huddersfield Banking Company, for example, added to the economic health and wealth of the region as a whole. Those who established this bank had a strong sense of the common good that the bank could provide for the region. Those benefiting would be the shareholders or owners of the bank, who, in principle, sought to derive a personal profit from their investment. Yet, even shareholders could have motives other than profits. These were usually local investors (Newton, 2010) who often wished to invest in and to sustain successful local enterprises that contributed to the economic well being of the region in which they were located. The spin-off benefits for them would be a stable economic environment in which they could prosper but

¹ HSBCGA: Prospectus of the Huddersfield Banking Company, H41/18, 9 March 1827.

also an investment that they could monitor due to proximity. Such economic stability and prosperity would, of course, benefit the wider community.

Most of all, these banks were ‘public’ banks – they were owned by large numbers of shareholders rather than just a few individuals, as with their private predecessors. This point was amplified by their nature as ‘public’ rather than ‘private’ banks. A prospectus for a bank covering the North West of England considered that:

There is little doubt, consequently, that Public Banks may be formed in it, with great advantage to their Shareholders, as well as with great benefit to the public, and the following plan, for the establishment and union of a certain number of these Companies, is suggested (Joplin, 1827: 147).

This prospectus would give rise to the birth of the Manchester and Liverpool District Bank. It, although not directly a result of Joplin’s work, had similar aspirations of generating a ‘public’ and common good, as well as profit to the owners. Likewise another new bank in the North West, the Ashton Stalybridge Hyde & Glossop Bank, stated at a meeting of the bank’s provisional committee in 1836 that ‘any joint-stock bank founded as a local establishment should promote the prosperity of the district it embraces’.²

In summary, joint-stock banks promised to serve local communities; to provide greater stability in the banking system in comparison to private banks; and to provide more reliable credit facilities. The prospectuses of these institutions, shown here, were keen to advertise their support of the economic interests of the regions in

² RBS Archives: 10144, Ashton Stalybridge Hyde and Glossop Bank, Board of Directors Minutes, 2nd March 1836.

which they were located. There was a strong sense of these institutions being established for the ‘common good’ of communities, not just merely for the profit of shareholders. The motivations of the founders thus appear to have been virtuous in character.

Qualifications and selection to the board

This section examines those that were eligible to be elected to the Board of Directors by bank shareholders, as well as investigating the differences in practice and processes between banks. The deeds of settlements and articles of associations have been analysed as these documents specified the qualifications of the bank director for each bank.

Two key qualifications for directorships - proximity to the bank and the possession of a minimum number of shares - were universally apparent across the banks examined. Deeds of settlement usually stipulated that directors had to be local. For example, the Bank of Liverpool’s directors had to live within 20 miles of the town hall.³ All banks examined required their directors to hold a certain amount of shares. The number depended on each bank: for Moore & Robinsons Nottingham Banking Company it was 300 shares; for the Liverpool Union Bank it was 100 shares, for the Coventry & Warwickshire Bank at least 25 shares, and for the Bilston Banking

³ Bank of Liverpool’s Deed of Settlement in *The Making of the Modern World: Part I: The Goldsmiths’-Kress Collection, 1450-1850*.

Company 50 shares.⁴ These terms would have ensured that directors should appear to stand as representatives of all shareholders to oversee decision-making and form a check over policy. The qualification, in terms of shareholding, also ensured that only those that were wealthy and of good social standing succeeded.

These qualifications acted to restrict the pool of candidates available to a single bank. As banks were promoted as local enterprises, the location-based criteria would ensure that they had relatively little access to stand as a director on other bank boards. Several articles of associations were more specific in reaching this aim and explicitly barred their directors from holding multiple bank directorships and thus acting as a banker for other firms. This restriction applied only to the business of banking, as directors were free and able to become directors and work in other sectors. Indeed, many early nineteenth century bank directors ran other commercial enterprises in the region (Newton, 1996). The banks wished to ensure that their directors sat on one bank board to avoid conflicts of interests (institutions were competing with each other) and to ensure that directors devoted their energies to promote and run one bank only. A bank would thus wish to capture the ‘virtue’ of its director’s in an exclusive fashion.

The actual processes for election to the board differed greatly between banks. Elections ensured that only those that were in good moral, social and economic standing, in the eyes of the shareholders, would succeed to become a director. Social

⁴ RBS Group Archives, Deed of Settlement for the Bilston District Banking Company, CST/5; Liverpool Union Bank’s Deed of Settlement in *The Making of the Modern World: Part I: The Goldsmiths’-Kress Collection, 1450-1850*; Lloyds Bank Archive, Coventry and Warwickshire Banking Company, Directors Minute Book, 1835-1837, Book Number 045 and Moore and Robinsons Banking Company.

standing was an integral part of the criteria, as articulated by a contemporary writer on banking who argued that each shareholder ‘has an opportunity of knowing and choosing those capitalists whom he thinks or knows to be the most upright and judicious of his partners, to form a Board of Direction for the management of his property’ (Anon, 1833 p.14).

If a director was elected in between annual general meetings, on the other hand, processes were not always as democratic or open. Interim elections would typically take place within the Board of Directors meetings in the event of the resignation or death of a director. For example, at interim elections at the National Provincial Bank of England, candidates were pre-selected. At board meetings, the existing crop of directors supplied names of potential candidates. Those candidates that the board favoured were then given the allotted amount of shares and so endorsed.⁵ For National Provincial, the potential directors were thus picked not from the original shareholding, despite the appearance of share ownership as qualifications to the outside, but rather these men began as ‘external’ candidates and were selected to be voted for.

Was there some merit in this approach? On the one hand, free and open elections would appear to be a virtuous way in which to elect directors. Formal elections of pre-ordained candidates may not have been as ethically sound but could ensure that the most suitable candidates for the job were elected. Here, there was a

⁵ RBSGA: National Provincial Bank of England: Branch committee minute book of National Provincial Bank of England, NAT/1/2 (December 1833 – 1836), RBSGA: National Provincial Bank of England: Branch committee minute book of National Provincial Bank of England, NAT/1/3 (March 1836 – 1839).

difference in the judgement of ‘virtue’, suitability and skill-set by shareholders versus existing directors. The aims of these two constituent groups were, however, likely to be the same – a stable and profitable bank. Pre-selection by directors limited the role of the shareholder in the process.

Managers, on the other hand, did not have similar qualifying characteristics or mechanisms to be held accountable. Bank managers were men that were appointed to run the bank on a day-to-day basis and received a salary in return. They did not run other businesses or have another job. In general, they would be elected by the Board of Directors and removed by them. Local appointments of unknown individuals were made, in some cases, on the recommendation of important members of the community and they would vouch for their integrity. Managers, like all members of staff, had to provide security (usually in the form of money, an amount related to their salary) and sign contractual agreements to commit to good and virtuous behaviour. In cases of unknown individuals, it was common for a more senior individual to provide this security. Yet the majority of both staff and managers were, like directors, members of the local community. Even those from the ‘outside’ could quickly become embedded in their new locations. Thus bank managers and bank staff tended to be monitored via local communities, as were directors.

It was, therefore, always intended that directors, unlike managers, were ‘insiders’ – of and within the local/regional bank and the community in which it was located - and in every example shown here, directors were connected to the bank through ownership of shares. Although exact distance from the bank and the quantity of shares differed across the sample, these were clauses that appeared as standard across the banks examined. But, in terms of personnel, expertise and skills, banks and

their shareholders were entirely free to appoint any person they felt held suitable to represent their interests, although, as shown by the example National Provincial, these were qualities that could easily be constructed.

The role of community in monitoring the virtuous behaviour

Given that banks, for a large part of the nineteenth century, conducted business at a local or regional level (Barnes and Newton, 2014), bank directors existed within local society and the business, familial and social networks found within. As these directors existed in close-knit local business communities in which they operated (often running local commercial enterprises), they were accountable first and foremost to their peer group.

Some have argued that those who committed fraud or were otherwise guilty of malpractices were not held accountable and instead slipped through legal measures (Wilson, 2014). As such, this chapter focuses only on extra-legal measures or ‘informal’ sanctions. While extra-legal measures were undoubtedly informal, they nevertheless had the same capacity to punish and to therefore establish acceptable and unacceptable behaviours (Marx, [1845] 1998). If an individual had a tendency to defect from co-operative engagements, they would find it more difficult to enter into profitable trades because other ‘players’ would be required to build higher monitoring costs into their transactions, and therefore the numbers of mutually profitable transactions would shrink (Ridley, 1996: 80-2; Kitcher, 1993). Thus the local business community could detect opportunistic behaviour amongst its members and ‘punish’ such behaviour through the withdrawal of business.

The business community and its associated networks, therefore, operated as a monitoring mechanism that provided a strong disincentive for potential defaulters or transgressors from acceptable behaviour, who faced punishment through the loss of trust, reputation and connections so vital to business success (Granovetter, 1985; Dore, 1983; Powell, 1990; Uzzi, 1997). In this way the business community enacted sanctions and could enforce virtuous behaviour from within. Indeed, Carnevali found in the case of regional Italian banks, 'peer monitoring adds another element to the reduction of moral hazard' (Carnevali, 1996). Solomon argues that membership of a given community, with corresponding rules, ideals, practices, goals and expectations, ties the individual to common community goals and responsibilities (Solomon, 1993). He states:

'Business is practice. It presupposes a (more or less) organized society (or societies) that shares all sorts of agreements about the good life and how to get there, about what is fair exchange and what is not, about how to interact and what must not be' (Solomon, 1993,: 186).

King summarises that 'Business derives its telos from service to the larger community. It is also constrained by the moral practices of the larger community' (King, 2001: 492).

To analyse such community monitoring more closely, two case study banks will be examined. The Manchester and Liverpool District Bank had a maximum of 24 directors, all of which were shareholders and all originating from the key areas from which the bank operated. In 1829, on its promotion, the Bank possessed 19 directors, each taken from the local area and comprising a mixture of wealthy individuals established in local or national politics, such as esquires or gentlemen, and

businessmen.⁶ This group, however, did not include the manager who was salaried and appointed by the board rather than the shareholders. He was responsible, as a full time employee, for carrying out most of the day-to-day operations of the bank.

In contrast, National Provincial Bank of England, with its much larger geographical remit, had different communities and spheres of influence over its decision-making. With a head office and a Board of directors in London, and banking activity in English provinces, these men were disconnected from the places in which they did business. This did not, however, mean that the community played no role in monitoring or establishing behaviours.

The National Provincial Bank of England covered a wide spread of regions through a branch network. It followed distinct processes to establish a new branch in this network. Shareholders in the provinces sometimes requested a local branch. These individuals would oversee the branch's manager, and its transactions. Indeed, the Bank's Board of Directors relied upon a series of local directors. Unlike the Board in London, local directors would be well known within their community. Those responsible for broad, strategic decision-making for the organisation as whole would be based in London but those responsible for local decisions (lending, deposit-taking, etc.) would be known, local faces.

The two examples used here of the Manchester and Liverpool District Bank and National Provincial Bank of England, although very different in terms of size and operations, were both embedded within their local communities but in different ways. Importantly, with National Provincial Bank of England's system of local directors, the

⁶ RBS Group Archives, Deed of Settlement for the Manchester & Liverpool District Banking Company, DIS/2.

bank had a local point of contact in the same way as the Manchester and Liverpool District Bank. The immediate community could hold these men directly accountable for their actions. As a result, this system tended to ensure virtuous behaviour by bank directors and to ensure that the motivations on which they were founded - for the common good of local communities - persisted. The motivation of profit, to ensure success and survival, obviously also followed.

Overall, only those outside of these networks were exempt from these informal punishments. For the most part, the directors (and usually managers and staff), as well as those other members of the community who recommended them, had an awful lot to lose in terms of their position within local society and operation of their local businesses. In both of the examples used here, the community ensured that those at the bank were incentivised to behave in a way that virtuous.

Accountability

The previous sections have established the ways in which a style of community-based monitoring worked in practice. Joint-stock banks had induced local society to join in a venture to improve the district and invited them to form a board of directors to oversee how the banks were run. This sections moves on to question if this style of governance prevented self-interest and un-virtuous behaviour.

Examples of poor or un-virtuous conduct within these two banks have been difficult to find. That does not, however, mean that these banks and bankers were always well behaved. Why were examples of malpractice so difficult to find? Instances of fraud and undesirable behaviour would undoubtedly be fairly shameful

and embarrassing and required openness, honesty and disclosure in order to be discovered. Nevertheless, within a small and localised community, the spread of information would be fast and instances of fraud would be recognised, if not always recorded.

More to the point, examples of scandalous behaviour can be found elsewhere. Like the Manchester and Liverpool District Bank, the Northern and Central Bank of England was also based in the North West, but, in contrast, it was unsuccessful. It failed in 1836 (and was liquidated in 1839) due to over-ambitious branch expansion and what contemporaries saw as management failure, as opposed to fraud (Lobban, 1996; Taylor, 2013). It served as a reminder of the nature of unlimited liability. Prior to 1858, bank shareowners were not protected by limited liability. In the case of the Northern and Central Bank of England, shareholders and directors alike were reluctant to pay their share of the bank's debts. Directors were made bankrupt. The event served as a reminder of the catastrophic consequences of allowing management of a bank to go unchecked. Yet these directors were not exposed to the vilification that the fraudulent Burdekin suffered, thus communities differentiated between deliberate fraud and bad business judgement.⁷

Burdekin was involved in the failure of another bank in the North West. In the case of the Bank of Manchester (established in 1829), fraud was the root cause of the failure. The fraud was committed by Burdekin, the manager (and later managing director), although no legal proceedings were brought against him for his crimes. The

⁷ See the testimony of Henry Moulton, a director, on shareholders generally in Select Committee Report on Joint-Stock Banks (P.P. 1837, XIV), and the William Seddon, the bank's solicitor in Select Committee Report on Joint-Stock Banks (P.P. 1837-8, VII)

Bank had used Burdekin to represent his institution in both its legal and parliamentary activity, before his crimes were uncovered.⁸ Burdekin did not remain within his community to face the consequences of his actions but rather he absconded to America. Thus, he avoided community punishment. Yet his exile ensured that he was punished for his behaviour.

After Burdekin left, the remaining directors exposed Burdekin's fraud and embezzlement. A guide to Manchester explained that he was personally to blame and that 'many of the losses were sustained in consequence of the lenience shown by him to a number of personal friends' (Swindells, 1907 p.281). The bank failed in 1843. Thus, in this case, community monitoring failed and local networks was unable to prevent such a crime in this case.

Given that most banking took place at a local level, those in the business community were best able to monitor and regulate bankers. A 'good' business reputation, as demonstrated by being held trustworthy by members of the business community, was a valuable asset. In the place of regulation or the security provided by a central bank, the local business community and its associated networks could thus operate as an informal monitoring mechanism and provide a supervisory role that offered a strong disincentive for those who may look to defraud and who faced losing the trust, reputation and connections so vital to business success (Lamoreaux, 1996). Mostly this worked. Yet Burdekin's story shows that the threat of observation and identification did not always serve to prevent deception. On the other hand, such active fraud as Burdekin's was rare. More common were failures, such as the Northern and Central Bank of England, that were considered by contemporaries to be

⁸ Report of the Committee of Secrecy on the Bank of England charter (P.P. 1832, VI)

due to mismanagement rather than fraud. In total, 138 joint-stock banks were established between 1826 and 1844 and of these only 19 failed. A failure rate of 13.5 per cent was considerably less than that of the private country banks (Cottrell and Newton, 1999: 83-4). Overall, therefore, the system by which local communities monitored directors of these early joint stock banks to ensure that they met the promises of their prospectuses to serve the common good and that they behaved in a virtuous manner appears to have been largely successful.

Conclusion

Joint stock banks established after the 1825/6 financial crisis were promoted for the common good of the communities that they served, aiming to provide safe and stable banking facilities that would promote local/regional economic prosperity. The directors of these banks had a vested interest – they were members of the local community themselves. As ‘insiders’ to the community, directors held a position that was potentially insecure in that their economic and social status could be withdrawn by other community members if they transgressed, failed to act for a broad, common good or behaved in a manner that was considered un-virtuous by those around them. They had a lot to lose if they were not virtuous. Such community monitoring and sanction was not always successful, but, before 1844, on the whole, reciprocal duties of business and society largely ensured honest and virtuous behaviour and action for common good. The examples of the National Provincial Bank and the Manchester and Liverpool District Bank stand testament to such informal monitoring mechanisms.

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